

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF THE BRACKEN COUNTY)	
WATER DISTRICT NO. 1, BROOKSVILLE,)	
KENTUCKY, FOR (1) A CERTIFICATE OF PUBLIC)	
CONVENIENCE AND NECESSITY AUTHORIZING)	
SAID DISTRICT TO CONSTRUCT MAJOR IMPROVE-)	
MENTS AND ADDITIONS TO ITS WATER DISTRI-)	
BUTION SYSTEM, INCLUDING A NEW PUMPING)	CASE NO. 8323
STATION AND CONSTRUCTION OF A NEW MAIN)	
LINE, NEEDED TO SERVE WATER TO SAID)	
DISTRICT PURSUANT TO PROVISIONS OF)	
CHAPTER 74 OF THE KENTUCKY REVISED)	
STATUTES; (2) SEEKING APPROVAL OF THE)	
ADJUSTMENT OF WATER SERVICE RATES AND)	
CHARGES; AND (3) SEEKING APPROVAL OF)	
PROPOSED PLAN OF FINANCING SAID PROJECT)	

O R D E R

The Bracken County Water District No. 1 ("Bracken County") filed its application on August 25, 1981, for approval of adjustments to its water service rates, a certificate approving proposed improvements in the amount of \$945,000, and approval to borrow \$463,000 from the Farmers Home Administration ("FmHA"). The loan repayment period is to be 40 years at 5 percent with principal repayment deferred for the first 2 years. Waterworks revenue bonds are to be issued as security for the loan. The proceeds from the \$463,000 loan along with a \$471,500 FmHA grant and \$10,500 from applicants for water service are to be used to make the system's improvements on which bids were received April 1, 1982.

Bracken County is now serving approximately 460 customers. The proposed construction will add approximately 40 new customers, with the potential future growth of customers being about 4 percent per year.

Plans and specifications for the improvements have been approved by the Division of Water of the Department for Natural Resources and Environmental Protection.

A hearing was held on November 19, 1982, in the offices of the Public Service Commission, Frankfort, Kentucky. All parties of interest were notified with Western Bracken County Water District, Valley Hi Utility Company and the City of Brooksville being intervenors at the proceeding. Additional information requested at the hearing was filed on April 26, 1982.

Test Period

Bracken County proposed, and the Commission has accepted, the 12-month period ending June 30, 1981, as the test period in this matter.

Revenues and Expenses

Bracken County's net operating income for the test period was \$4,286. In order to reflect current operating conditions, Bracken County proposed numerous adjustments to revenues and expenses resulting in adjusted net operating income of \$29,208. The appropriate level of net operating income as determined by the Commission is \$26,243.

The Commission finds Bracken County's proposed adjustments to be generally proper and has accepted them for rate-making purposes with the following exceptions:

Water Sales

Bracken County was granted a rate increase during the test period. If those rates had been in effect the entire period, revenues of \$113,102 would have been produced. Moreover, Bracken County adjusted its water sales to reflect 40 new customers expected to be served upon completion of the construction project at an estimated average usage of 13,500 gallons per month. This usage is substantially higher than the average usage of its current customers, which is approximately 6,433 gallons per month. A schedule of water demand trends and forecasts filed as part of Bracken County Exhibit A-1 shows expected usage of approximately 200 gallons per day or 6,000 gallons per month. The Commission is of the opinion that 6,000 gallons per month is more representative and has therefore used this amount in its calculation of expected water sales from the additional customers, resulting in an adjustment of \$5,160 to water sales. Thus, the Commission has increased operating revenue by \$33,542 to reflect a normalized level of customers at expected average usage.

Inflation Adjustments

Many of the adjustments proposed by Bracken County included estimates and projections based solely on expected inflation rates without any documentation to support the specific cost

increases. Since Bracken County did not provide documentation or evidence to support these cost increases, the Commission has rejected them, resulting in a reduction in Bracken County's adjusted operating expenses of \$2,408. In addition, Bracken County proposed an adjustment of \$1,000 for contingencies associated with the maintenance of mains and an adjustment of \$1,000 for anticipated materials and supplies. Because the adjustments are neither known nor measurable and are merely estimates, the Commission has further rejected these expenses. Thus, Bracken County's adjusted operating expenses have been reduced by a total of \$4,408.

Electricity Expense

Bracken County proposed to adjust its electricity expense to reflect price increases during the test period and projected price and volume increases from customer growth for the first full year after Bracken County's construction program is to be completed. The Commission has re-computed this adjustment using the most recent prices charged Bracken County by its electricity supplier, Kentucky Utilities Company, and rejected Bracken County's estimated future price increases which are neither known nor measurable. In its computation, the Commission adjusted test period volumes for expected usage following construction, less Bracken County's ability to operate its pumps more efficiently after construction, a net increase of 4.5 percent. This results in reasonable electric costs of \$26,796, a reduction of \$3,975 from the \$30,771 proposed by Bracken County.

Chemical Expense

Bracken County proposed to adjust its chemical costs for projected price changes during the first full year following completion of its construction program. Again, the adjustment of \$190 has been rejected as being neither known nor measurable. Subsequent to the hearing, Bracken County's consulting engineer presented evidence that additional chemical treatment costing \$1,249 was needed to eliminate a sediment problem experienced for several years. The Commission will allow an adjustment of \$1,249 to reflect this additional cost.

Salaries and Related Tax Expenses

Prior to the completion of its construction program, Bracken County proposed an adjustment for estimated wage increases anticipated to occur after the construction has been completed due to additional duties in maintenance and line flushing. Subsequent to the hearing, Bracken County reduced its pro forma line flushing expenses from \$1,000 to \$600. The Commission concurs with this revised amount. However, the Commission rejects the estimated additional maintenance cost and projected wage increases to Bracken County's employees since these adjustments are neither known nor reasonably measurable. This results in a reduction to operating expenses of \$1,907. Related increases in payroll taxes proposed have been reduced by \$127.

Professional Fees

During the test period, Bracken County incurred professional fees of \$6,800 comprised of \$5,000 for a cost study and

\$1,800 for the previous rate case, Case No. 7936. Since these costs are not expected to recur annually, the Commission is of the opinion that they should be deferred and expensed over a period of time representative of their benefit to Bracken County. Thus, the Commission has amortized the cost study over 5 years and the rate case expenses over 3 years, for a reduction of \$5,200 to Bracken County's proposed operating expenses.

In response to a Commission request, Bracken County provided evidence indicating that the estimated expense for the current case is \$2,000. The Commission accepts this as a reasonable fee for case preparation and has amortized it over 3 years producing an increase in operating expenses of \$667. In addition, Bracken County proposed that its operating expenses be adjusted to reflect expected new recurring expenses not included in the test period for accounting and auditing fees of \$2,000, its legal retainer of \$1,500 and consulting engineering fees of \$800. The Commission accepts these adjustments. Thus, the Commission has reduced Bracken County's operating expenses by a net amount of \$233.

Insurance Expense

Bracken County proposed an adjustment of \$600 as an estimate of additional insurance expense requirements after completion of its construction program. At the hearing, Bracken County was requested to furnish evidence of this estimate. No appropriate evidence has been received by the Commission, and this adjustment has therefore been rejected.

Maintenance of Mains

During the test period, Bracken County incurred maintenance of mains expense of \$3,833. It was determined during cross-examination that some portion of the expense should have been capitalized. In response to Commission requests, Bracken County stated that \$2,784 of the expense was capital in nature. Thus, the Commission has reduced proposed operating expenses by \$2,784.

Depreciation

Bracken County proposed depreciation expense of \$47,161. In reviewing the procedure used in determining this amount, it was noted that additions made during the test period were depreciated for only that portion of the test period in service and not annualized. Annualizing these items produces projected depreciation expense of \$48,800. It is the Commission's policy that depreciation expense be computed on the basis of original cost of the plant in service less contributions in aid of construction, as the utility should not be permitted cost recovery on that portion of plant which has been provided free of cost. At the end of the construction program, net original cost less contributions in aid of construction will be \$1,010,597. Applying the projected composite depreciation rate of approximately 2.9 percent produces depreciation expense acceptable for rate-making purposes of \$29,475, a reduction in adjusted depreciation expense of \$17,686.

Sales Tax

Because sales tax is merely collected and rendered to the

State Treasurer, the amounts should be recorded neither in revenues nor expenses. Thus, both revenues and expenses have been reduced by \$249.

Therefore, the Commission finds that Bracken County's adjusted test period operations are as follows:

	<u>Actual</u>	<u>Adjustments</u>	<u>Adjusted</u>
Operating Revenues	\$ 85,670	\$ 33,542	\$119,212
Operating Expenses	123,879	(30,910)	92,969
Net Operating Income	<u>\$(38,209)</u>	<u>\$ 64,452</u>	<u>\$ 26,243</u>

Revenue Requirements

The Commission has used the debt service coverage method to determine appropriate revenue requirements for Bracken County. Bracken County's pro forma average debt service for the next 5 years, including financing of the planned construction project, is \$55,688. Bracken County's debt service coverage on adjusted net operating income of \$26,243 plus actual interest income of \$3,074 is 0.53X. The Commission is of the opinion that a debt service coverage of 1.2X is fair, just and reasonable to meet the requirements of Bracken County's bondholders and to pay expected operating expenses. Therefore, annual revenues of \$156,720 are required to provide a reasonable debt service coverage.

The rates proposed by Bracken County based on test period usage and expected usage found reasonable by the Commission for new customers will produce annual revenues of \$148,119. Bracken County's debt service coverage on this level of revenues is 1.03X.

The Commission is of the opinion that the rates proposed by Bracken County are insufficient to meet the minimum requirements of its bondholders. Therefore, the Commission has increased the proposed rates to produce annual revenues of \$156,720 necessary to provide the fair, just and reasonable debt service coverage of 1.2X, which will insure the financial stability of Bracken County and its ability to provide continued good service to its customers.

Rate Structure

Bracken County's present rate structure consists of three retail customer classifications and one wholesale classification, each with two rate blocks. Class B customers have a minimum usage level of 4,000 gallons and Class C and F customers have minimum usage levels of 1,000 gallons. Further, Class B, C, and F customers receive the same service, but are placed in the present classes according to anticipated usage. Customers are not changed from their initial classification even though actual usage may vary from the anticipated usage upon which that classification was based. Approximately 18 percent of the utility's customers use 1,000 gallons or less per month and average usage is approximately 6,000 gallons per month. The minimum usage for wholesale customers is 50,000 gallons.

Bracken County proposed to place all customers, except wholesale, in a single classification with a minimum usage level of 2,000 gallons. Bracken County's witness, Stewart Owens, and

the utility's response to the Commission's Order of October 29, 1981, indicate that the proposed change was determined through review of rates of other utilities in the surrounding area having a comparable number of customers.

Bracken County presently has three wholesale customers: Western Bracken Water District, Valley Hi Utility Company, and City of Brooksville. No special construction was required to serve these customers. The present wholesale rates and the rates proposed by Bracken County result in costs to these wholesale customers in excess of those which would be incurred if water were billed at the general retail rates, and, in effect, subsidize the small user. The design of wholesale rates should recognize that the administrative costs associated with serving a large volume user are less than those which would have been incurred if the same volume were sold to individual small users. The Commission has, therefore, made appropriate adjustments to provide a more equitable balance between the retail and wholesale rates.

Summary

The Commission, after consideration of the record and being advised, is of the opinion and finds that:

1. Public convenience and necessity require that the construction proposed in the application and record be performed and that a certificate of public convenience and necessity be granted.

2. The proposed construction will be for comprehensive

improvements and expansion of the existing distribution system. It will provide for the flow of greater quantities of water needed to serve new customers and to improve the quality of service to existing customers. The proposed construction and system improvements include a booster pump station, a 29,000-gallon clearwell, well pump improvements, a master metering station, 13,860 feet of 12-inch pipe, 21,660 feet of 10-inch pipe, 13,660 feet of 8-inch pipe, 3,940 feet of 6-inch pipe, 2,300 feet of 2-inch pipe, 15 service connections, 9 fire hydrants and other improvements at a total project cost of \$945,000 based on the total of low bids received on April 1, 1982, of \$615,049.

3. Any deviations from the approved construction which could adversely affect service to any customer should be subject to the prior approval of this Commission.

4. The proposed borrowing of \$463,000 is for lawful objects within the corporate purposes of Bracken County, is necessary and appropriate for and consistent with the proper performance of services to the public by Bracken County, will not impair its ability to perform these services and is reasonably necessary and appropriate for such purposes.

5. Bracken County should furnish duly verified documentation of the total cost of this project including the cost of construction and all other capitalized costs (engineering, legal, administrative, etc.) within 60 days of the date that construction is substantially completed.

6. Bracken County's contract with its engineer should require the provision of full-time resident inspection under the general supervision of a professional engineer with a Kentucky registration in civil or mechanical engineering. This supervision and inspection should insure that the construction work is done in accordance with the contract plans and specifications and conforms to the best practices of the construction trades involved in the project.

7. Bracken County should require the engineer to furnish a copy of the record plans and a signed statement that the construction has been satisfactorily completed in accordance with the contract plans and specifications within 60 days of the date of substantial completion of this construction.

8. The rates and charges in Appendix A are the fair, just and reasonable rates to be charged by Bracken County in that they will provide for more equitable billing for all customers, and will produce gross annual revenues of approximately \$156,720 which will allow Bracken County to service its debt and pay its reasonable operating expenses.

IT IS THEREFORE ORDERED that Bracken County be and it hereby is granted a certificate of public convenience and necessity to proceed with the proposed construction as set forth in the contract plans, specifications and finding number two herein.

IT IS FURTHER ORDERED that any construction deviations from the contract plans and specifications hereby approved,

which could adversely affect service to any customer, shall be subject to the prior approval of this Commission.

IT IS FURTHER ORDERED that Bracken County be and it hereby is authorized to borrow \$463,000 from the Farmers Home Administration at 5 percent over a 40-year period with payment of principal deferred for 2 years and to issue waterworks revenue bonds as security therefor.

IT IS FURTHER ORDERED that Bracken County's plan of financing in the amount of \$945,000 be and it hereby is approved.

IT IS FURTHER ORDERED that Bracken County shall file with the Commission duly verified documentation which shows the total costs of construction herein certificated including all capitalized costs (engineering, legal, administrative, etc.) within 60 days of the date that construction is substantially completed.

IT IS FURTHER ORDERED that the contract between Bracken County and its engineer shall require the provision of full-time resident inspection under the general supervision of a professional engineer with a Kentucky registration in civil or mechanical engineering. This supervision and inspection shall insure that the construction work is done in accordance with the contract plans and specifications and conforms to the best practices of the construction trades involved in the project.

IT IS FURTHER ORDERED that Bracken County shall require the engineer to furnish the Commission with a copy of the record drawings and a signed statement that the construction has been satisfactorily completed and done in accordance with the contract

plans and specifications, within 60 days of the date of substantial completion of the proposed construction.

IT IS FURTHER ORDERED that the rates and charges in Appendix A be and they hereby are approved as the fair, just and reasonable rates and charges to be charged by Bracken County for service on and after the date of this Order.

IT IS FURTHER ORDERED that within 30 days of the date of this Order, Bracken County shall file its tariff sheets setting out the rates and charges approved herein.

Nothing contained herein shall be deemed a warranty by the Commonwealth of Kentucky, or any agency thereof, of the financing herein authorized.

Done at Frankfort, Kentucky, this 9th day of June, 1982.

PUBLIC SERVICE COMMISSION

Marlin M. Volk
Chairman

Katharine Randall
Vice Chairman

Don Rapp
Commissioner

ATTEST:

Secretary

APPENDIX A

APPENDIX TO AN ORDER OF THE PUBLIC SERVICE COMMISSION IN CASE NO. 8323 DATED JUNE 9, 1982

The following rates and charges are prescribed for the customers served by Bracken County Water District No. 1. All other rates and charges not mentioned specifically herein shall remain the same as those in effect under authority of the Commission prior to the effective date of this Order.

RESIDENTIAL, COMMERCIAL, AND INDUSTRIAL

GALLONAGE BLOCK

First 2000 gallons
Over 2000 gallons

MONTHLY RATE

\$8.50 minimum
1.55 per 1000 gallons

CONNECTION FEE

\$350.00

WHOLESALE

GALLONAGE BLOCK

First 50,000 gallons
Over 50,000 gallons

MONTHLY RATE

\$95.00 minimum
1.40 per 1000 gallons